

**UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION**

**INVESTMENT ADVISERS ACT OF 1940
Release No. 3273 / September 7, 2011**

**ADMINISTRATIVE PROCEEDING
File No. 3-14536**

In the Matter of

**MONTFORD AND COMPANY,
INC. d/b/a MONTFORD
ASSOCIATES,**

and

ERNEST V. MONTFORD, SR.,

Respondents.

**RESPONDENTS' OPENING BRIEF
ON THE MERITS**

RESPONDENTS' BRIEF ON THE MERITS

On May 17, 2012, the Commission granted the Petition for Review of Respondents Montford and Company, Inc. and Ernest V. Montford, Sr. (collectively "Montford"). Pursuant to Commission Rule of Practice 450, Respondents submit this Opening Brief on the Merits and urge the Commission to reverse the Initial Decision issued on April 20, 2012 in the above captioned proceeding ("Initial Decision").

I. Introduction and Summary

Montford is A 65 year old investment advisor with no record of any prior violations of law. In this case, Montford was charged with violations relating to the failure to disclose payment that Montford received from a fund manager for services unrelated to, and not contingent upon, advice that Montford gave his clients. The fund manager -- Stanley J. Kowalewski ("SJK") -- turned out to be a fraud, and, because of

SJK's fraud, Montford's clients lost money. There was no evidence or even contention by Division that Montford had any role in, or knowledge of, the fraud. Indeed, Montford himself was a victim of the fraud, having invested his own retirement funds with SJK.

The Division issued its Wells Notice to Montford on March 4, 2011. Under Dodd-Frank, Division had 180 days, until August 31, 2011, to file an action against Montford. 15 U.S.C. § 78D-5. Division missed the Dodd-Frank deadline, filing seven days late, on September 7, 2011. The Administrative Law Judge refused to dismiss the action, however, and the case proceeded to trial.

In the Initial Decision, the ALJ found that Montford had violated Sections 206 and 207 of the 1940 Act by failing to disclose the payment received from SJK. The sanctions imposed by the ALJ were stunning in their severity. The two extremes presented at the trial of the case by the litigants were as follows: Montford argued that he was not liable but, even if he were liable, it would be unjust to impose monetary sanctions above "Tier One." Division, at the other extreme, argued for the imposition of Tier Two monetary sanctions of \$25,000 for both Montford and his company (for a total of \$50,000), an amount far in excess of recoveries in similar cases. *See e.g., Sheer Asset Management*, 1995 CCH ¶ 85,609 (\$10,000 civil penalty, and no disgorgement, for failure to disclose payments over a three year period from broker to investment advisor of \$150,000). The ALJ did not rule between either extreme, and instead imposed Tier Three monetary sanctions twenty times greater than those sought by the Division, imposing monetary sanctions of \$150,000 upon Montford and \$500,000 upon Montford and Company, Inc. The ALJ also ordered that Montford "disgorge" the \$210,000 received from SJK for services rendered, refusing to deduct from that amount

the reasonable value of the services or the \$40,000 that Montford had already paid in restitution to a client who had been defrauded by SJK. The ALJ also barred Montford from the business of investment advisor, even though there was no showing or contention that Montford had ever before violated any law.

II. Facts

A. Montford Associates

1. Montford Associates was founded in 1989 by Ernest V. Montford, a seasoned investment advisor with long tenures at Merrill Lynch & Co., Inc. and E. F. Hutton & Co. Montford Associates and Ernest Montford are registered investment advisors licensed by the S.E.C. [Ex. 2] In its 22 years, Montford had attracted a variety of institutional investors, but most of Montford's clients were non-profit foundations, educational institutions, and quasi-governmental entities. [Ex. 11]

2. Montford has an unblemished record of compliance with the law. Montford has never been cited by the government for any violation of the law no matter how minor or trivial. [T. 138]. Montford has also escaped litigation in civil securities cases, with the sole exception a case brought by an investor against Merrill Lynch and Montford which Merrill Lynch succeeded at having dismissed at the trial court level. That dismissal was reversed by the court of appeals and, rather than continue to incur expenses of litigation, Merrill Lynch agreed to settle the case for \$30,000. There was no admission or evidence of any wrongdoing.

B. Hedge Fund Of Funds And Investment Strategy

1. Montford developed investment strategies to meet the particular needs of individual clients. Many of Montford's clients placed a higher value on the preservation of capital than on maximizing the potential for fast growth. [T. 43]. For these clients,

Montford would generally recommend investments that have a relatively low volatility and, in some instances, investments that are hedged against various economic conditions. [T. 138-39].

2. One particularly appropriate kind of investment for institutions valuing security and preservation of capital over growth is a hedge fund of funds. *Id.* Though known by different names, hedge fund of funds have been an investment vehicle of choice for decades at the largest and most prestigious endowments in the world, including Harvard and Yale. [T. 143]. The basic concept of a hedge fund of fund is simple: an investment that is divided among funds having contrasting investment strategies is likely to be less volatile and can be “hedged” against various economic conditions. [T. 143]. The key to a successful fund of funds is the fund’s manager’s ability to select the right mix of underlying fund managers and to allocate the right percentage of money between them. [T. 139].

3. Montford has recommended that clients invest in hedge fund of funds for many years. Montford’s clients have been invested in at least six different fund of funds, including Common Sense, Oakbrook Market Neutral, PIMCO All Asset, as well as Summit and SJK, discussed in greater detail below. [T. 140].

C. SJK’s Fund Of Funds

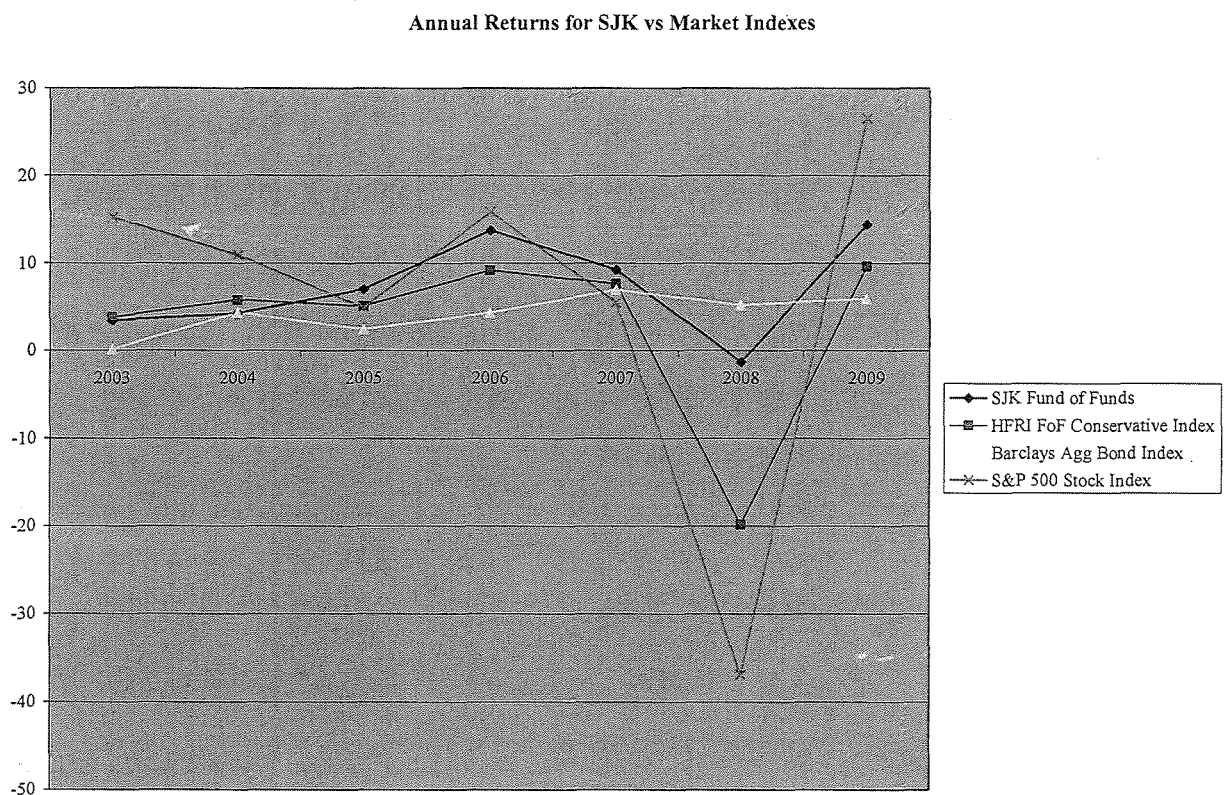
1. A fund of funds manager that Montford starting using in the 2000s was SJK, who at the time had his own firm called Phoenix Partners. [T. 34].

2. Since 2003, Montford has recommended SJK to many clients. As of December, 2010, sixty percent of Montford’s clients had money invested with SJK, representing 15% of Montford’s assets under management [T. 21].

3. In February 2010, Ernie Montford – convinced that SJK was a solid and

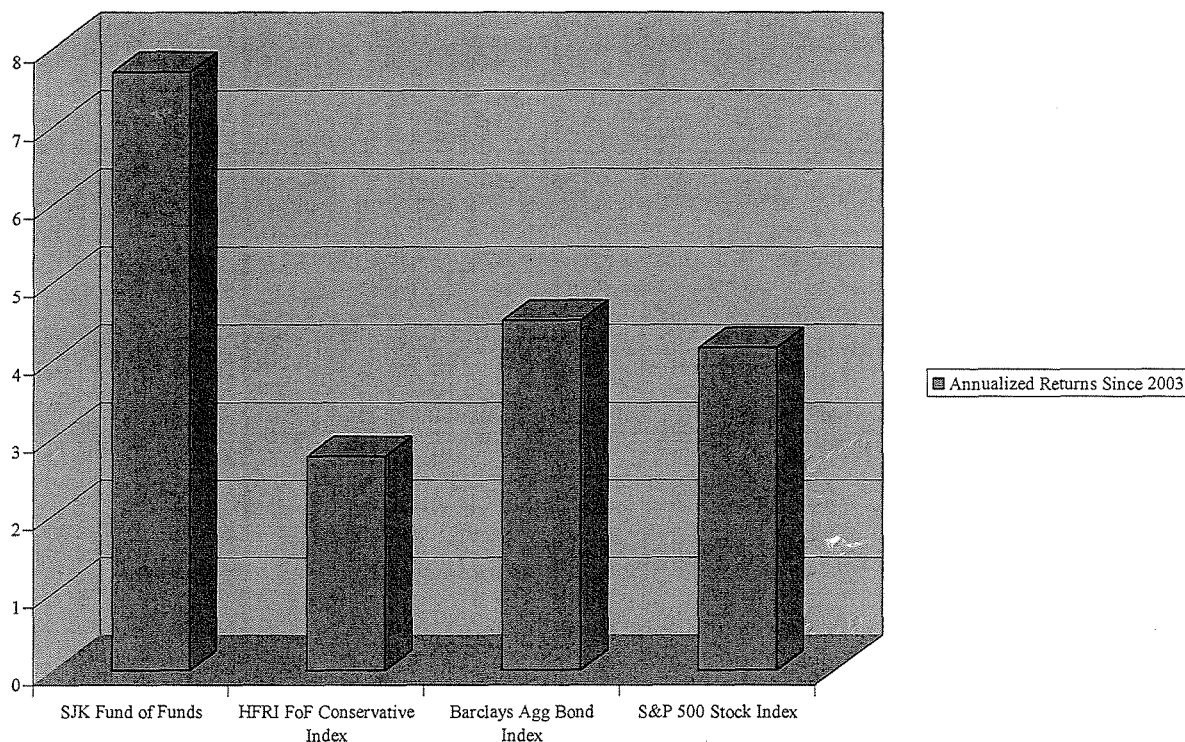
safe investment – invested his personal retirement account (worth over \$200,000) with SJK. [Ex. 19].

4. Over the years, SJK's performance had been outstanding by any measure. [T. 141-142]. Chart 1 compares SJK's performance to the performance of the HFRI Index of Conservative Fund of Funds, Barclays Agg Bond Index, and the S&P 500 Stock Index for the period 2003 through 2009:



As this chart shows, SJK's returns were both less volatile and measurably higher than the HFRI Index. And, although the S&P outperformed SJK in 2009, S&P's cumulative returns over the seven year period were not nearly as good. Indeed, of the four, SJK's annualized returns since 2003 were the highest, by far:

Annualized Returns Since 2003



5. SJK's returns may have been the most impressive in 2008, the year in which the S&P 500 dropped 37%, more than it had in any year since 1937. Even other hedge fund of funds – specifically designed to weather economic cycles – lost, on average, 20%. SJK's funds were down only 1.5%, net after fees. *Id.*

D. SJK's Movement In And Out Of Columbia Partners

1. Over the years, SJK's funds migrated from organization to organization. [T. 35]. When Montford first started recommending SJK, SJK owned a firm called Phoenix Partners. In 2004, SJK sold Phoenix Partners to Global Alternatives in Atlanta, but SJK continued to manage the funds. [T. 35; T. 44]. In 2005, Columbia Partners hired SJK to create a similar hedge fund of fund business as a separate division of Columbia. [T. 36]. At that time, Montford assisted with the transfer of Montford's client's funds from Global Alternatives to Columbia at no charge to either Montford's

clients or to SJK.

2. In 2009, SJK informed Montford that SJK might be leaving Columbia to set up his own firm because of differences with the firm's owners over SJK's compensation. [T. 39]. Montford advised SJK to not make the move in light of (a) the number of moves that SJK had already made in the prior years, (b) the increased sensitivity of the investing public caused by the Madoff scandal, and (c) the administrative difficulties associated with transferring the funds and setting up his own business. [T. 39]. SJK nevertheless decided to leave Columbia and set up his own company. [T. 43].

3. When SJK left Columbia, Montford's clients that had funds invested in Columbia had three choices. [T. 147-48]. First, they could leave the funds invested with Columbia. Second, they could withdraw the funds and invest with another manager altogether. Third, they could move the funds with SJK and reinvest in what would be an almost identical hedge fund of funds, with the same underlying funds and only a nominally different top-level fund manager (SJK NewCo instead of Columbia Partners, managed by SJK).

4. At the time, Montford was considering these options with his clients, Columbia announced that it was exiting the fund of funds business and that it would not support Montford's clients' investments. [T. 147; T. 47; Ex. R-2]. That left only two options – stay with SJK or find a new fund of funds manager. Though moving to a new fund of funds manager was clearly an option available to Montford's clients, there was no compelling reason to make such a move and strong reasons to stay with SJK. As noted above, SJK had shown the ability year after year – and most immediately in 2008 – to sustain good returns and, most important, to avoid losses of capital in hard times.

Since SJK's record far surpassed other fund of funds managers, most of Montford's clients elected to stay with SJK.

E. Montford Assists Columbia and SJK

1. Meanwhile, in July 2009, at SJK's request, Montford began assisting SJK with the transfer of Montford's clients' funds from Columbia to SJK's new company. Initially, when SJK's funds were housed within Columbia, Columbia had sufficient administrative expertise to handle the administratively complicated work associated with managing a fund of funds. When SJK left Columbia, Columbia made the decision to liquidate the funds and exit the "hedge fund of fund" business entirely – but did so without retaining the administrative expertise necessary to appropriately handle Montford's clients' accounts. For its part, SJK's new operations also did not have this kind of administrative experience or expertise. [T. 182]. The work necessary to take care of Montford's clients' accounts therefore "defaulted" to Montford – but it was work that Montford, in all fairness, had no responsibility for completing. Montford was paid to advise clients, not to administer or transfer funds from one hedge fund of funds to another.

2. Montford knew from experience that this effort would be time consuming. But the move from Columbia to SJK's new company proved even more difficult. For reasons that were never made clear to Montford, Columbia refused to transfer the funds "in kind" simply by changing the identity of the owner of the top-tier funds (and not disturbing the ownership of the monies in the underlying funds). [T. 150-55]. As a result, Montford's clients' interests in the underlying funds had to be redeemed, the proceeds distributed to the respective Columbia fund of funds, then transferred to the new SJK fund of funds, and then invested again in the underlying funds. Each of these

steps had to be completed for each of Montford's eight clients, each of which had interests in eleven underlying funds. [T. 155; *see also* T. 292].

3. The work that Montford's staff did to transition the funds from Columbia to SJK's new funds was substantial, and involved several "waves" of activity. In early July 2009 (approximately July 10), SJK informed Montford that SJK was leaving Columbia and would need help transitioning the underlying funds for Montford's clients. Montford's staff spoke to each of its eight clients to explain what Columbia was doing. [T. 154; *see also* T. 66-67]. Montford then received and processed the forms necessary for investing in the SJK funds. [T. 154-155]. On July 14, 2009, Columbia sent an announcement directly to Montford's clients informing the clients that the Columbia fund of funds was going to be liquidated. [Ex. R-2]. This was unexpected. [T. 148]. The announcement was poorly handled, and required Montford to meet with each of the clients to explain the mechanics of the transfer. Montford then worked with clients assisting them make their requests to Columbia for "in kind" transfers. [T. 149]. Columbia, however, refused. [T. 158; Ex. R-15]. Mr. Montford met with Columbia's COO to try to change Columbia's mind, to no avail. As a result of this refusal, Montford's staff had to complete another round of paperwork. [T. 181]. Complicating matters, Columbia circulated conflicting notices to investors as to when investors had to notify the fund of their intent to withdraw. [e.g. T. 67]. Columbia first sent an announcement stating that all investors had a July 31 notification deadline to withdraw from the fund by August 31, 2009. [T. 182]. This short notice prompted a flurry of activity involving bank wiring instructions, withdrawal notices, and the like. By August, however, Columbia circulated a new notice that the closure date was being changed from August 31, 2009 to September 20, 2009, a change that required Montford to go

through the whole process again. There was additional confusion when it appeared that the real closure date was not September 20, but September 30. Worse, Columbia – which had no staff with experience liquidating a fund of funds – circulated incorrect forms and instructions.

Finally, by October 15, 2009, 90% of the funds that had been invested in the Columbia Funds had been transferred. From October 2009, through the beginning of 2010 (and to some extent long thereafter), Montford worked with Columbia and SJK to secure the transfer of the remaining funds. [See generally T. 69-71]. As the ALJ noted at the hearing, the Division did not question “that this was all messy.” [Need citation for “this is all messy” quote from alj]

F. Montford Asks SJK for Payment for Services Rendered

Introductory statement. The payment that Montford received from SJK was at the heart of every Division allegation. In the Initial Decision, the ALJ repeatedly states or suggests, without citation to the record, that there was evidence of some connection between payments SJK made to Montford for services and Montford’s advice to his clients. In fact, there was no connection. Uncontradicted evidence established that Montford would have been paid the same (by SJK or his clients), whether Montford recommended SJK or another fund. In fact, the fund distribution that Montford recommended resulted in SJK receiving only 15% of the amount of money that Montford had under management, and for some clients Montford recommended another fund of fund manager, not SJK. But there is simply no evidence of any actual or even theoretical conflict of interest.

1. Though Montford had started to assist SJK without a commitment by SJK to pay for the services, by August 2009 the amount of work required of Montford had

become unreasonably burdensome. During the week of August 25, 2009, Ernie Montford told his staff that he believed the company should not do this work for free, and his overburdened staff heartily agreed. [T. 55]. Since it was not an expense his clients should have endured, Montford called SJK and told him that Montford needed to get paid for the work. [T. 167]. SJK agreed that Montford would be paid a fee for the work. SJK did not tell Montford how SJK would calculate or determine the payment. From Montford's perspective, any payment would be more than Montford was expecting prior to that conversation; Montford had a good relationship with Kowalewski at the time, and Montford had every reason to believe that the fee would be modest but also reflect the effort his company was undertaking on behalf of SJK. Montford did not believe the money he received from SJK was a "fee" as that term is used on the Form ADV. [T. 168].

2. The amount of money that SJK would pay Montford had nothing whatsoever to do with the amount of funds Montford's clients would or might invest in SJK. [T. 161 *et seq.*]. Toward the end of 2009, SJK's accountants told Montford that payment would be made in 2010. SJK ended up paying Montford \$130,000 in January 2010 and \$80,000 in November 2010.

3. The \$210,000 that Montford was paid for the work was the reasonable value of the services rendered. Significantly, there was no evidence of any ill-gotten gain; instead, it was an even exchange – Montford received no more than the reasonable value of its services.

4. There was no evidence that the payment to Montford was contingent upon Montford referring clients to SJK. [T. 163-64]. Montford testified to the contrary [T. 161 *et seq.*], and Division made the tactical decision to not call to the witness stand

the only other party to this agreement – SJK. There was no documentary evidence supporting the assertion that Montford would have been paid any less by SJK had he referred fewer clients to SJK, or that he would have been paid any more had he referred more clients to SJK. Finally, there was no evidence that the investment advice to invest in SJK, based upon everything that Montford knew or could have known at the time, was not sound or that it was motivated by anything other than reasonable and good-faith investment advice. In sum, there was no evidence of any conflict of interest.

5. Significantly, SJK's agreement to pay Montford for its work came long after Montford's clients had decided to transfer their funds from Columbia to SJK. [T. 149-50; Ex. R-3]. On July 23, 2009, Montford wrote Columbia Partners and informed Columbia that all of Montford's clients "would like to avoid any unnecessary taxable event and all desire to exit the Columbia Absolute Return fund and transfer their interests in the Underlying Fund Managers to either the SJK Absolute Return Fund LLC or the offshore version, SJK Absolute Return Ltd." [T. 148; Ex. R-3]. Montford did not discuss payment with SJK until the end of August 2009.

G. SEC Early on Discoveries Fraud

1. We now know that soon after SJK opened his new firm he started defrauding clients, including Montford. Sadly, as detailed below, the SEC knew of the facts constituting the fraud long before the fraud was disclosed to the investing public and, for reasons that have never been explained, did nothing about it. The fact that the SEC was aware of the facts constituting SJK's fraud early on is important to this case on a number of levels. First, if there were ever any doubt, it confirms that Montford could not have known anything about the fraud. If the S.E.C., which was auditing SJK throughout this time period, did not "connect the dots" establishing SJK's malfeasance,

then of course Montford – who knew far less -- could not have done so. Second, Montford believes the evidence also explains why the Commission staff missed the Dodd-Frank Deadline, discussed in greater detail below. SJK's fraud, and the S.E.C.'s failure to detect it, gave Commission staff some appropriate humility and ambivalence about prosecuting a case against Montford: Commission staff knew that Montford, like the S.E.C., had been fooled by SJK, knew that Montford was a victim himself, and knew that the real culprit in all of this was SJK. Montford was another victim, not a perpetrator, of the fraud. Division was never certain it wanted to prosecute the case against Montford and that ambivalence led them to miss the deadline. Third, the S.E.C.'s understanding of the actual fraud perpetrated by SJK gave Commission staff, once it decided to file the action, some perspective -- a greater sense of how Montford's mistakes compared in the scheme of things. Fourth, this evidence was directly relevant to – and refuted – the imposition of Tier Three sanctions, as discussed below in Part III.

2. Remarkably, a single document establishes the S.E.C.'s knowledge early on of SJK's fraud – Proffered Exhibit R-39, the April 16, 2010 transcript of the S.E.C.'s deposition of SJK. The deposition was taken nine months before SJK's fraud was disclosed to the investing public. In the intervening nine months, investors poured millions more into SJK's funds, investments that would have never been made or lost had Division acted on SJK's alarming admissions of guilt. Montford tendered the deposition as evidence in the case, but Division's objection to the evidence was sustained by the ALJ. It is in the Commission's records as Proffered Exhibit R-39.

3. SJK's deposition shows the following: the S.E.C.'s investigation of SJK was in full swing by the time SJK opened his new company. By December 2009, the S.E.C. had discovered (unbeknownst to Montford, SCDS, and other investors) that SJK's

Form ADV had materially misrepresented SJK's assets under management. SJK had stated in his official filings that he had over \$75 million under management. In fact, at the time this representation was made, SJK had just under \$21 million under management. Though the S.E.C. knew that SJK had misstated – by \$54 million – the amount SJK was managing, that fact did not alarm the S.E.C. investigators enough for the S.E.C. to warn the investing public or take any serious regulatory action. As a result, the public continued to invest in SJK. Montford himself invested his entire retirement account in SJK in mid-2010, well after the S.E.C. had learned of SJK's material misrepresentations in its ADV.

Worse, by April, 2010, the S.E.C. had learned that SJK had siphoned millions from the Absolute Return Funds into a new, aptly named "Special Opportunity Fund." (SJK Dep. April 16, 2010, p.71, 86) ("We just launched a new fund, the SJK Special Opportunities Fund." "Well, it's just as the name implies, it is a special opportunities fund that looks at a variety of different investments from real estate to fixed income to equities, there's a variety of different things.") SJK further told the S.E.C. that the Special Opportunity Fund had invested in local real estate and had loaned money to a local construction company called Combs. The S.E.C. did not ask who owned the "local real estate" or construction company (the answer: SJK's relatives) or whether such "investments" were consistent with a low-risk hedge fund of funds. The S.E.C. also learned that SJK was not having the Special Opportunity Fund audited, that a local bank had been engaged as the custodian (rather than Goldman Sachs, the custodian for the legitimate funds), and that SJK was administering the fund himself. (*Id.*, pp. 74, 85). The S.E.C. also had reviewed the documentation making it abundantly clear that the

Absolute Return Fund was contractually prohibited from investing in a fund managed by SJK, and was contractually prohibited from investing in real estate.

The S.E.C. also knew that investments in real estate and loans to local construction companies were totally out of character for a low risk hedge fund of funds. It was this creation and funding of the Special Opportunity Fund, disclosed to the S.E.C. by April 2010 that led to the massive losses later in 2010, the S.E.C.'s eventual lawsuit, the receivership, SJK's disbarment and censure. Still, at the time the S.E.C. learned of the Special Opportunity Fund, the S.E.C. apparently did not put the pieces together, did not notify the investing public, and did not take any serious regulatory action. As a result, the public continued to invest in SJK. In December, 2010, a full year after the S.E.C. had learned of SJK's \$54 million misrepresentations in the ADV, and 8 months after the S.E.C. learned of the fraudulent Special Opportunity Fund, Hickory Springs Pension Fund invested \$7 million in SJK.

H. Montford Cooperates with the S.E.C.

1. All during this time period – from before SJK left Columbia until late 2010, the Atlanta Division of the S.E.C. had been investigating SJK and uncovering SJK's fraud, but it was not until December 2010 that Montford was made aware of the Division's findings by way of receiving a subpoena duces tecum from the Atlanta Division, asking Montford to appear for a deposition and requesting Montford to bring with him virtually every document that Montford had relating to SJK. [T. 134; Ex. 1].

2. The subpoena informed Montford that the investigation was "a non-public fact-finding inquiry." [T.133; Ex. 1]. Division also instructed Montford to keep the fact of the investigation confidential. Montford did so, and did not divulge to any client the nature of the investigation.

3. Montford, without counsel, immediately responded, gather all relevant documents in his files, and took them to the Atlanta Division.

4. Division was aware when it took Montford's deposition the first time that Mr. Montford's initial production was not complete. For example, it was obvious that no electronic documents had been produced. Further, it is not unusual in litigation for a deposition to proceed before the document production is complete – exactly as SJK did in Division's investigation of him nine months before. [See, e.g., Proffered Ex.R-39; SJK April 2010 Depo. at p. 7].

5. At Montford's first deposition, the examination understandably focused on the \$130,000 invoice that had been produced, and did not address what other payments might have been made by SJK. Still, Montford answered each question accurately. Then, shortly after the first deposition, Montford found and produced the \$80,000 invoice, along with other documents, and agreed to sit for another deposition. In the cover letter producing the additional documents, Montford's counsel highlighted the existence of the \$80,000 invoice to make sure that Division was aware of its existence. [Ex. R-6].

6. The St. Joes' group was the largest of Montford's clients and lost the most money due to SJK's fraud. [T. 171-172]. St. Joes brought a civil action under the Investment Advisors Act against Montford. The case was settled. St. Joes dismissed its claims with prejudice in exchange for Montford paying St. Joes \$40,000. [T. 171].

7. There was no evidence that equitable relief is necessary to prevent Montford from violating the law. [T. 176].

I. Commission Staff Misses Dodd-Frank Deadline

1. This Division issued the Wells Notice to Montford on March 4, 2011. By

the time the Wells Notice was issued, Division had already been investigating the matter for months. Montford had already produced all his documents, and Division had already taken Montford's deposition twice. Thus, by the time Division issued the Wells Notice, its investigation was complete and Division would have been ready to file an OIP had it desired to do so. (In fact, the OIP that was filed more than 180 days later did not contain any new facts, allegations or theories of recovery).

2. There is no evidence of any need by virtue of the complexity of the investigation for an extension of time to file the action.

3. There is no evidence in the record that the Director of Enforcement found that the investigation was sufficiently complex such that a determination regarding the filing of the action against Montford could not be completed within 180 of the issuance of the Wells notice.

III. Exceptions to ALJ's Rulings

A. The ALJ Erred in Failing to Dismiss the Case for Failure of the Division to Comply with the Dodd-Frank 180 day Rule

The ALJ erred by not dismissing the case after Division failed to comply with 180-day filing requirement of Section 929U of the Dodd-Frank Wall Street Reform and Consumer Protect Act ("Dodd-Frank"), 15 U.S.C. § 78d-5.

1. Background.

(a) **The Dodd-Frank Deadline.** Dodd-Frank sets a statutory "DEADLINE FOR COMPLETING ENFORCEMENT INVESTIGATIONS" (the "Dodd-Frank Deadline"):

Not later than 180 days after the date on which Commission staff provide a written Wells notification to any person, the Commission staff shall either file an action against such

person or provide notice to the Director of the Division of Enforcement of its intent to not file an action.

15 U.S.C. § 78d-5(a)(1) (emphasis added). If the Director of Enforcement determines that the investigation is “sufficiently complex,” the Director of Enforcement may grant a 180-day extension of time within which to file an action. 15 U.S.C. § 78d-5(a)(2).

The Dodd-Frank Deadline is not onerous in any respect whatsoever. If the Division is not ready to prosecute an action by filing a complaint, then all it has to do is withhold issuing a written Wells notification until it is ready to do so. The Dodd-Frank Deadline does not hamper any investigation. It merely requires Division, if it is going to issue a written Wells notification, to get on with the filing of a formal complaint.

(b) **Undisputed Facts.** The Atlanta Regional Office issued a Wells Notice to Respondents on March 4, 2011. Under Dodd-Frank, Division had 180 days, until August 31, 2011, to file an action. 15 U.S.C. § 78d-5(a)(1). This action was not filed until September 7 – seven days late. The OIP does not allege compliance with the Dodd-Frank Deadline or that any extension had been granted by the Director of Enforcement because the investigation was “sufficiently complex.”

(c) **Respondents’ Motion to Dismiss.** Since the OIP was filed in violation of Dodd-Frank Deadline, Respondents on September 8, 2011 filed a Motion to Dismiss. In response, Division conceded that the deadline was missed, but made two arguments against dismissal. First, Division argued that the failure file within 180 days was not fatal to the prosecution of the action because the statute did not impose a real deadline. But see 15 U.S.C. § 78d-5 (statute is entitled “Deadline for Completing Enforcement Investigations and Compliance Examinations and Inspections”). Second, Division argued that, even if the Dodd-Frank Deadline was, in fact, a “deadline,” Division met the

deadline by obtaining a ten-day extension from the Director of Enforcement. But Division presented no evidence of such an extension apart from the self-serving hearsay affidavit of their lawyers, and even that “evidence” fell short of the statutory requirements. Dodd-Frank requires that the Director of Enforcement, or his or her designee, determine that the particular investigation is “sufficiently complex such that a determination regarding the filing of an action against a person cannot be completed” within the 180-day deadline. 15 U.S.C. § 78d-5(a)(2). Division did not even allege, much less present any evidence, that the Director of Enforcement made the determination required by Dodd-Frank.

It is critical to be very clear on these undisputed facts. This is not a case in which Division has taken the position that the Director of Enforcement made the complexity determination. Division has never represented, in briefs or in the hearing before the ALJ, that the Director of Enforcement actually made the determination that Dodd-Frank requires, that is, that the investigation is “sufficiently complex such that a determination regarding the filing of an action against a person cannot be completed” within the 180-day deadline. 15 U.S.C. § 78d-5(a)(2).

That Division is not even attempted to make this showing should not be a surprise. Division’s investigation was completed by the time it issued the Wells notification; it could have filed the OIP on day 1, rather than stalling for over six months. By the time the Wells notification was issued – before the statute of limitation had *begun* to run – Division had collected all the documents, deposed Montford twice, and formulated and articulated every single theory that it would end of advancing in the case. The Director of Enforcement could never have said (and, to his or her credit, never did say) that the investigation was “sufficiently complex” such that a decision whether to

file against Montford could not have been completed within the 180-day deadline. That decision could have been made on day 1. As a result, there was no extension granted in conformity with the statute and Commission staff missed Congress's deadline for filing the action.

(d) **ALJ Denies the Motion to Dismiss.** Meanwhile, on October 5, 2011, the ALJ denied the Motion to Dismiss. The ALJ's entire analysis is contained in the following sentence: "the complex nature of the proceeding is demonstrated by the fact that the Commission directed that an Initial Decision be issued within 300 days, the time allowed for deciding the most complex proceeding" under 17 C.F.R. § 201.360.1 No other fact or law was cited in support of the holding that the extension had been obtained in compliance with Dodd-Frank.

(e) **Commission Denies Interlocutory Review.** The Commission issued an Order Denying Suggestion for Interlocutory Review on November 9, 2012.

(f) **Trial.** At trial, Division presented no further evidence of compliance with Dodd-Frank.

(g) **Initial Decision.** In the Initial Decision, the ALJ denied reconsideration of Montford's motion to dismiss. The ALJ stated: "Here, the Director extended the deadline, so one can deduce that he/she made the determination, which the Commission affirmed when it directed that an Initial Decision be issued within 300 days of service of the OIP, the time period for the most complex administrative proceedings." [Initial Decision, Page 13.] To clarify: there is no evidence from the Director that he or she extended the deadline. The ALJ also did not consider the possibility that "he/she

¹ The October 5, 2011 Order actually cites to 17 C.F.R. § 320, but that section deals with evidence. Respondents have assumed that the ALJ intended to cite to 17 C.F.R. § 360, which addresses the 120, 210 and 300-day time limits for the issuance of an Initial Decision.

did *not* make the determination” required by the law -- a far more likely possibility, given (a) the total lack of evidence that he or she did so, (b) the fact that Division does not even claim that he or she did so, and (c) the fact that Division had already completed its investigation (collecting all the documents, deposing Montford twice) by the time it issued the Wells notice and could have filed charges on day 1.

2. Reasons for reversal.

This case presents an ideal fact pattern for the Commission to enforce Congress’s clear command in Dodd-Frank for investigations to be undertaken in a prompt, disciplined and lawful manner. The facts are not in dispute: the IOP was not filed until after the 180 day period had expired, and there is no evidence (or even contention by Division) that the Director of Enforcement made the findings that the statute requires for an extension. Two reasons have been advanced to not dismiss this case. The argument advanced by the ALJ (but not joined by Division) is that the Commission’s selection in the OIP of a 300-day schedule under Rule 360 for the *trial* of the case demonstrates that this case is complex and, since the trial of the case was complex, the Director would have been authorized to find that the *investigation* was complex, and had the Director done so the Commission staff might have been granted a proper extension. The Division, wisely, does not adopt this argument, and it is facially illogical and entirely without merit. For its part, the Division argues the law, and contends that the Commission staff’s failure to follow the law has no consequence – in other words, only Respondents and other investment advisors have a duty to obey the law: for the Government compliance is optional. That argument also is without merit.

(a) The ALJ's Reasoning is Without Merit

The ALJ erred by holding that the Director's failure to make the Dodd-Frank determination was retroactively excused by the Commission's selection in the OIP of a 300-day schedule under Rule 360 ("the Rule 360 Guidelines"). If the case is sufficiently complex to deserve a 300-day schedule, the ALJ reasoned, the investigation leading up to the filing of the case must have also been complex. This non sequitur cannot be sustained by the Securities and Exchange Commission in the face of Congress's clear command.

First, the ALJ confuses two separate deadlines: the Dodd-Frank Deadline, which addresses the time period between the issuance of the Wells Notice and the initiation of an action, and the Rule 360 Guidelines, which addresses the next time period, from the initiation of the action through the issuance of the Initial Decision. The stated considerations for determining the appropriate deadline are also different. Under the Rule 360 Guidelines, the Commission has the authority to specify one of three time periods (120, 210 or 300 days) running from the date of the issuance of the Order Instituting Proceedings until the issuance of the Court's Initial Decision. The Commission is to make this determination "after consideration of the nature, complexity, and urgency of the subject matter, and with due regard for the public interest and the protection of investors." Significantly, "complexity" is only one of the factors. The decision to specify a 300-day deadline could be made in a case that is not complex, particularly if the matter (like this one) is not urgent and the longer period is in the public interest. Conversely, the Commission clearly has the discretion to specify a 120-day deadline in a very complex case if, for example, the matter is urgent and a quick decision is in the public interest. Obviously, the Commission's selection of the 300-day

Fourth, and most important, Respondents submit that it is entirely inappropriate and almost bizarre for the ALJ, or the Commission, to engage in these contortions for the purpose of trying to find an excuse for the Commission staff's failure to follow the law, particularly when Division itself does not even support the argument. The law is not complicated. It is either to be enforced as written or, for reasons that have never been advanced by the ALJ or Division, not enforced as written. Respondents understand that the ALJ is experienced and has been in other cases a fair judge. But here, the ALJ clearly decided that the law should not be enforced but, having no basis for that conclusion, fabricated this argument that is so wholly without merit. The Commission, however, has this opportunity to make the intellectually honest determination as to whether the S.E.C. will follow the letter and spirit of Acts of Congress.

(b) Division's Argument is also without merit

Before the ALJ, the Division cited a single case, *Brock v. Pierce County*, 476 U.S. 253 (1986), for the proposition that a failure to comply with the 180-day Dodd-Frank Deadline had no consequence. The *Brock* case is instructive, but the Court's analysis in that case leads to the conclusion that this action is time barred.

Brock addressed whether the Secretary of Labor had jurisdiction to investigate misuse of federal funds pursuant to a law that required the Secretary to determine "the truth of the allegation or belief involved, not later than 120 days after receiving the complaint." In *Brock*, the Secretary did not complete its investigation of the defendant until after 120 days, and the defendant argued that the action was time barred. The

Supreme Court disagreed, holding that the 120 day language in the statute did not divest the Secretary of jurisdiction to pursue actions for misuse of federal funds.

In its analysis, the Supreme Court in *Brock* relied heavily on the absence of any language in the statute saying what should happen if the Secretary did not meet the 120 day deadline. 476 U.S. at 259 (adopting reasoning of a line of court of appeals cases, holding that statutory time limits are not jurisdictional unless the statute “both expressly requires an agency or public official to act within a particular time period and specifies a consequence for failure to comply with the provision” (citation omitted)). In this case, however, the statute is explicit, and gives the Commission two options: file the complaint within 180 days or dismiss the action.

In *Brock*, the Supreme Court also explained that interpreting the 120 day rule as a statute of limitation would place hardship upon the Secretary that Congress was not likely to have intended. In making this point, the Supreme Court expressly distinguished a statute like the 180 day rule, which merely requires the filing of an action:

Section 106(b), by contrast, does not merely command the Secretary to file a complaint within a specified time, but requires him to resolve the entire dispute within that time. This is a more substantial risk than filing a complaint, and the Secretary’s ability to complete it within 120 days is subject to factors beyond his control. There is less reason, therefore, to believe that Congress intended such drastic consequences to follow from the Secretary’s failure to meet the 120-day deadline.

476 U.S. at 261. Thus, the Supreme Court in *Brock* expressly distinguished rules like the Dodd-Frank 180 Rule, which simply requires the filing of a complaint within the specified period of time. In addition, unlike Section 106 in *Brock*, which left the Secretary “subject to factors beyond his control,” the Dodd-Frank 180 Rule leaves the

S.E.C. with complete control over the timing by having the period run from the initiation of the action with the issuance of a Wells Notice. If the Commission staff is not ready to investigate and resolve the dispute, all the Commission staff needs to do is to withhold the issuance of the Wells Notice until it is ready to do so.

Further, the statute in *Brock* had none of the language making it obvious that Congress intended the deadline, indeed, to be a deadline. In Dodd-Frank, Congress detailed the procedures pursuant to which the Commission could obtain an extension of the deadline if the investigation were sufficiently complex. If the Commission were free to file the action at any time, regardless of whether it complied with Congress's rules for obtaining an extension, those rules would serve no purpose. In addition, if there were any doubt as to whether Congress intended the 180-rule to be a deadline, the title of the law gives it away: "15 USC § 78D-5 - DEADLINE FOR COMPLETING ENFORCEMENT INVESTIGATIONS AND COMPLIANCE EXAMINATIONS AND INSPECTIONS."

The ALJ's decision reflects a clear error of law and should be reversed.

B. The ALJ Erred in Imposing Third Tier Monetary Sanctions

The ALJ imposed monetary sanctions in the amount of \$150,000 for Mr. Montford and \$500,000 for Montford and Company, sanctions that were, respectively, six and twenty times the sanctions sought by the Division. [Initial Decision at 23 (imposing sanctions); *id.* at 17 (stating that Division requested sanction requiring each respondent to pay \$25,000)]. The ALJ's imposition of Third Tier Monetary Sanctions was riddled with reversible errors way beyond their sheer severity and harshness given the facts of this case.

First, the ALJ did not even address, much less consider fairly, the statutory bases for the imposition of Third Tier Monetary sanction. The statute on penalties, 15 U.S.C. § 80b-3(i), sets maximum penalties for three tiers.

(1) Maximum amount of penalty

(A) First tier

The maximum amount of penalty for each act or omission described in paragraph (1) shall be \$5,000 for a natural person or \$50,000 for any other person.

(B) Second tier

Notwithstanding subparagraph (A), the maximum amount of penalty for each such act or omission shall be \$50,000 for a natural person or \$250,000 for any other person if the act or omission described in paragraph (1) involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement.

(C) Third tier

Notwithstanding subparagraphs (A) and (B), the maximum amount of penalty for each such act or omission shall be \$100,000 for a natural person or \$500,000 for any other person if—

- (i)** the act or omission described in paragraph (1) involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; and
- (ii)** such act or omission directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons or resulted in substantial pecuniary gain to the person who committed the act or omission.

On page 22 and 23 of the Initial Decision, the ALJ cited this statute, but then does not discuss them at all or make *any* factual findings necessary for the imposition of Tier Three penalties. Instead, the ALJ concluded that such penalties “are warranted given Respondents’ brazen conduct toward their non-profit clients and should serve to deter other fiduciaries from similar self-serving conduct.” (Initial Decision, p. 23). Even if the ALJ’s conclusions were factually correct (and they are not), those

conclusions have nothing to do with the statute, which requires a finding that the respondent's conduct "created a substantial risk of substantial losses" or resulted in "substantial pecuniary gain." The statute does not allow enhanced penalties based on the corporate status of the investor (non profit or for profit), says nothing about deterrence, and does not list "brazen conduct" as a consideration. Some of these considerations might be worthy objectives for other penal regimes, but none of them are factors selected by Congress for the violations asserted in this case.

Further, the absence of evidence on the statutory elements for the imposition of Tier Three sanctions is not surprising since Division never sought Tier Three damages. From the OIP to its post-trial brief, Division sought only Tier Two damages. This reflected Division's belief that it could not prove that Montford's actions – in addition to involving fraud and deceit – also caused "substantial losses" or "created a risk of substantial losses" or "resulted in substantial pecuniary gain" to Montford. To the contrary, Division knew that the losses were caused by SJK, that Montford had no more reason than the S.E.C. at the time to know of SJK's fraud, and that there was no connection between Montford's failure to disclose the fee and any of his clients losses – those losses were caused by SJK's fraud.

Second, in imposing the Third Tier sanctions, the ALJ did not cite, recite, or apply the express statutory considerations of the public interest found at 15 U.S.C. § 80b-3(i)(3).² Instead of following the statute, the ALJ listed "criteria most often used to

² The statutes provides:

(1) Determination of public interest

In considering under this section whether a penalty is in the public interest, the Commission may consider—

assess the public interest.” [Initial Decision at 17]. Among other omissions, the ALJ failed to consider “the extent to which any person was unjustly enriched, taking into account any restitution made to persons injured by such behavior.” Id. In considering monetary sanctions, the ALJ should have taken into account, among other things, that the ALJ was separately ordering full restitution in the form of the disgorgement remedy. The ALJ also did not take into consideration that Montford had never “been found by the Commission [or any other regulatory agency] to have violated the Federal securities laws.” Id. The ALJ’s failure to apply the correct statutory considerations of the public interest is clear reversible error.

Third, the ALJ erred by imposing Third Tier sanctions against Respondents because Division, having sought only “Second Tier” sanctions, presented no evidence or even argument that “Third Tier” sanctions were appropriate. Since Division did not

(A) whether the act or omission for which such penalty is assessed involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement;

(B) the harm to other persons resulting either directly or indirectly from such act or omission;

(C) the extent to which any person was unjustly enriched, taking into account any restitution made to persons injured by such behavior;

(D) whether such person previously has been found by the Commission, another appropriate regulatory agency, or a self-regulatory organization to have violated the Federal securities laws, State securities laws, or the rules of a self-regulatory organization, has been enjoined by a court of competent jurisdiction from violations of such laws or rules, or has been convicted by a court of competent jurisdiction of violations of such laws or of any felony or misdemeanor described in subsection (e)(2) of this section;

(E) the need to deter such person and other persons from committing such acts or omissions; and

(F) such other matters as justice may require.

present any evidence in support of Third Tier sanctions, Montford had no opportunity or occasion to present evidence or argument to rebut any finding that Third Tier sanctions were appropriate.

Fourth, the ALJ made a number of evidentiary rulings that were incorrect in that she excluded evidence relevant to Third Tier sanctions, evidence that would have shown that Montford's clients were not injured by Montford's acts and omissions (and that the injury, instead, was caused by others), and, when such evidence was admitted, it was ignored in the Initial Decision. For example, the ALJ excluded evidence that Montford's largest client itself received valuable gifts from SJK and was not relying upon Montford to invest in SJK, evidence clearly relevant to the issue of whether Montford's "act or omission directly or indirectly resulted in substantial losses" - a key Third Tier consideration. 15 U.S.C. § 80b-3(i)(2)(C)(ii). The most significant body of evidence excluded by the trial court was referenced above - the evidence establishing that SJK disclosed the facts of his embezzlement and fraud to the S.E.C. long before the S.E.C. ever disclosed those facts to Montford or to the rest of the investing public. *See infra* Part II G. Particularly given the ALJ's decision to stray from Division's recommendation for Tier Two damages, excluding this evidence was reversible error.

The fact that the SEC was aware of the facts constituting SJK's fraud early on is important on a number of levels. This evidence confirms that Montford could not have known anything about the fraud. If the S.E.C., which was auditing SJK throughout this time period, did not "connect the dots" establishing SJK's malfeasance, then of course Montford - who knew far less -- could not have done so. The evidence also explains why Division sought at most Tier Two sanctions. Commission staff knew that Montford, like the S.E.C., had been fooled by SJK, knew that Montford was a victim himself, and knew

that the real culprit in all of this was SJK. Montford was another victim, not a perpetrator, of the fraud. Division was never certain it wanted to prosecute the case against Montford in the first place, and that is why it took Division beyond the statutory deadline to decide to actually file the case.

Division's understanding of the actual fraud perpetrated by SJK gave Division, once it decided to file the action, some perspective -- a greater sense of how Montford's mistakes compared in the scheme of things. Thus, when Commission staff finally decided to file the case (too late, as it turns out), the upper bound of Commission staff's request for relief was Tier Two monetary sanctions -- a fraction of the penalties the ALJ actually imposed.

The ALJ, however, excluded all the evidence of SJK's fraud and the SEC's knowledge of SJK's fraud, and accordingly had no appreciation for how Montford's actions fit into the scheme of things and how Montford's actions had absolutely nothing to do with the losses suffered by Montford's clients (and Montford) at the hands of SJK. Division knew the real facts far better than the ALJ and, accordingly, did not even ask for Tier Three monetary damages.

But to the ALJ, there was no context for measuring Montford's actual culpability or the appropriate sanction. In the true picture of these events, SJK fills the entire frame and Montford, and the S.E.C. staff that failed to connect the dots, are bit players. By excluding the evidence of SJK's fraud, the ALJ stripped from her own view the context of Montford's actions. This might have been understandable (if not correct) and of less consequences had the ALJ also kept her sanctions within her more limited construction of the scope of the case. Certainly, if Tier Three sanctions would never have been considered, then there would have been less need to consider the causes of

the investors' losses – as client loss is not an element or consideration in Tier One and Tier Two sanctions, only Tier Three. But once the ALJ excluded evidence of the causes of client losses, she necessarily removed from any proper consideration Tier Three sanctions.

Fifth, even if any Third Tier sanctions might otherwise have been appropriate, the imposition of sanctions on Montford and Company that were twenty times greater than the amount sought by Division, and against Mr. Montford that were six times the amount sought by Division, was error of law. *See e.g., Sheer Asset Management*, 1995 CCH ¶ 85,609 (\$10,000 civil penalty, and no disgorgement, for failure to disclose payments over a three year period from broker to investment advisor of \$150,000).

Sixth, the ALJ imposed a monetary sanction of \$150,000 upon Mr. Montford [Initial Decision at 23], but the statutory cap on Third Tier monetary sanctions on individuals is \$100,000. 15 U.S.C. § 80b-3(i)(2). In addition, the ALJ stated incorrectly that the maximum sanction for corporations was \$750,000 [Initial Decision at 23]; the statute caps Third Tier monetary sanctions at \$500,000.

The ALJ's imposition of money sanctions must be reversed.

C. The ALJ Erred in Ordering “Disgorgement” of \$210,000

The ALJ erred in ordering disgorgement of \$210,000 [Initial Decision 20-21]. This is the amount that Montford received from SJK for the work Montford did assisting SJK set up his new company. There was no evidence that the payments were related to any advice that Montford had given or would give his clients.

The “disgorgement” remedy authorized by Section 203(j) is an equitable remedy and is appropriate only if the elements of that equitable remedy have been established by the Government. At bottom, the disgorgement of the \$210,000 was incorrect

because Montford did nothing wrong by receiving the \$210,000; the statutory violation charged was in failing to disclose that payment to his clients. Further, disgorgement is never applied to reverse payments received from the ultimate wrongdoer; here, there was no dispute that SJK defrauded everyone and was not entitled to restitution of the \$210,000 payment that he had made to Montford. Additional grounds for reversal include the following:

1. Disgorgement is appropriate to reverse a payment from the victim to the perpetrator; here, the payment came from SJK, the perpetrator, and was made to Montford, one of the SJK's. *See SEC v. Collello*, 139 F.3d 674 (9th Cir. 1998) (disgorgement applies to funds defrauding party took from victims).

2. Division contended that disgorgement applies to the "fruit of the fraud." But the payments from SJK were not the "fruit of the fraud" but the fruit of Montford's labor. The ALJ did not find that Montford committed fraud by working for and receiving money from SJK. That was not a fraud, and the fruits of that labor are not subject to disgorgement.

3. Disgorgement is an appropriate remedy when the amount of the money disgorged is equal (or at least related) to the damages caused by the receipt of the money. The ALJ made no finding of any relationship between the amount of money SJK paid to Montford and any damage caused by Montford's failure to disclose the payment to his clients.

4. The purpose of the disgorgement remedy is to protect the public. *SEC v. Cavanaugh*, 445 F.3d 105, 117 & n. 25. The ALJ did not find that disgorgement will protect the public.

5. Disgorgement only applies to profits that Montford derived. Here, the

ALJ disgorged the gross amount of payments Montford received. *See SEC v.*

Haligiannis, 470 F. Supp.2d 373 n. 10 (rejecting the SEC's position that it could recover gross payments); *SEC v. Blatt*, 583 F.2d 1325, 1335; *SEC v. Amerifirst Funding, Inc.*, 2008 WL 1959843.

6. Disgorgement is to "prevent unjust enrichment." *SEC v. Banner Fund Int'l*, 211 F.3d 602, 617 (D.C.Cir. 2000). The ALJ did not find that that SJK's payments to Montford unjustly enriched Montford.

D. Sanctions Extreme for Isolated Infraction.

In the Initial Decision, the ALJ barred Montford from the industry. This sanction was unwarranted, and the ALJ erred by, among other reasons, failing to take into account that if Montford had no prior record of any violation of law, a factor that the ALJ was bound under the law to take into account. *Monetta Financial Serv., Inc. v. S.E.C.*, 390 F.3d 952, 957 (7th Cir. 2004) (vacating Commission's order imposing sanctions because the Commission failed to consider, inter alia, the isolated nature of the violation). Courts and the Commission have emphasized the importance of the advisor's state of mind. *Steadman v. S.E.C.*, 603 F.2d 1126 (5th Cir. 1979). What Judge Tjoflat said in *Steadman* applies directly to this case: "It would be a gross abuse of discretion to bar an investment adviser from the industry on the basis of isolated negligent violations." 603 F.2d at 1141. Here, Montford did not know of the SJK fraud, did nothing to advance any of the fraudulent schemes, did not benefit from the fraud, and did not have any incentive to deceive its clients into investing in SJK. If Ernie Montford did not believe in SJK, Ernie Montford would never have invested his entire retirement account with SJK. Montford had no intent to harm anyone. *See S.E.C. v. Slocum, Gordon, & Co.*, 334 F.Supp.2d 144, 185, 187 (D. R. I. 2004) (for "non-scienter

based, technical violations” refused to impose injunctive relief, instead imposed \$3,000 civil penalty).

In addition, Mr. Montford has paid dearly. At 65, he has lost his retirement funds and, most important, lost his business. He has paid one client \$40,000 in restitution already, and has incurred well over a hundred thousand dollars in legal fees, not only defending himself but trying to help the Government prosecute SJK. There is no need to punish Mr. Montford further.

E. There Was No Violation of Section 206 under Capital Gains.

Montford did not violate the Act because the payments Montford received from SJK were not “fees” and did not, as a matter of fact and as a matter of law, cause or reflect any conflict of interest. In its holdings, the ALJ accepted the Division’s argument that, under *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963), any financial benefit to the advisor apart from advisory fees presents a conflict – irrespective of why the benefit was purportedly conferred – because such a financial incentive tends to taint the advisor’s objectivity and judgment. But *Capital Gains* does not so hold: “why the benefit” was conferred is the critical question. The Supreme Court in *Capital Gains* expressed concern “whenever advice to a client might result in financial benefit to the adviser – other than the fee for his advice.” Thus, the concern is the relationship between the advice to the client and the financial benefit. Certainly, if an investment advisor has a financial incentive to offer certain advice, under *Capital Gains* there is an actionable conflict of interest and potential violation of Section 206. But the key question is if “advice to a client might result in financial benefit to the advisor – other than for the fee for his advice.” If the advice to the client does not result in financial

benefit to the advisor, other than for the fee for his advice, then there is no conflict of interest, no violation of law, and no material information to disclose.

In this case, the evidence established that Montford's advice to his clients to invest in SJK (or, in some instances, to not invest in SJK), did not result in financial benefit or detriment to Montford whatsoever – Montford was paid the same number regardless of where the money was invested. There was no evidence to the contrary, no testimony, no documentary evidence, no calculations, or any tabulations or any other kind of evidence that would support any inference that Montford was paid by SJK to steer clients to SJK, or that Montford was paid more if he advised his clients to invest in SJK.

Oddly, Division did not even try to prove to the contrary. Division not only could have called SJK to testify, but also could have called any number of SJK's employees, who would have known of any such a deal (and, facing indictment, would have been eager to testify to please the S.E.C.). But Division did not call any witnesses to prove this critical piece of its case. Indeed, Division's factual presentation on this issue was so weak it is clear that Division believed that it only needed to show payment (which was conceded), and that did not need to show that the payment was to compensate Montford for steering clients to SJK.

In sum, the ALJ erred in not recognizing that Division had not carried its burden. As Justice Goldberg stated in *Capital Gains*, the key issue is whether "advice to a client might result in financial benefit to the advisor – other than the fee for his advice." 375 U.S. at 187. Division, not believing that it needed to prove the connection between the advice and the payment, presented no evidence in support of this critical element. Since

Division failed to carry its burden under Section 206 and Capital Gains, and the ALJ erred in the finding Montford liable.

F. There was no Section 207 Violation because the Economic Benefits Received from SJK were not “in connection with giving advice to clients”

The ALJ erred in holding that Montford violated Section 207 by failing to disclose on its Form ADV the fact of the payments from SJK. The Form ADV required disclosure of economic benefits “from a non-client in connection with giving advice to clients.” There was no evidence that the payments from SJK were made in connection with Montford giving advice to any clients. Similarly, Montford’s statement that it did not accept “fees” from managers in the Form ADV was meant in the same way as the Form ADV question – an economic benefit in connection with giving advice to clients – such as a finder’s fee or a commission.

G. Cease and Desist Order Unnecessary and Unlawful

The ALJ erred by issuing a cease and desist order because Division made no credible showing of “some cognizable danger of recurrent violation.” *Slocum*, 334 F.Supp.2d 144 at 185. The cease and desist order also is unenforceable because it does not specify the conduct prohibited, and instead simply requires Montford to “obey the law.” As such, it is unenforceable as a matter of law. *SEC v. Smyth*, 420 F.3d 1225 (11th Cir. 2005). “This circuit has held repeatedly that ‘obey the law’ injunctions are unenforceable.” *Id.* n.14. It is black-letter law that an injunction that commands a party to simply “obey the law” is not enforceable. *Hughey v. JMS Development Corp.*, 78 F.3d 1523 (11th Cir. 1996). *See also United States v. Philip Morris USA Inc.*, 566 F.3d 1095 (D.C. Cir. 2009) (“we have held injunctions to be too vague when they enjoin all violations of a statute in the abstract without any further specification, or when they

include, as a necessary descriptor of the forbidden conduct, an undefined term that the circumstances of the case do not clarify”).

For the foregoing reasons, the Initial Decision should be reversed.

This 25th day of June, 2012.



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